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No. 78-14

In the Supreme Court of the United States

OCTOBER TERM, 1978

MIRIAM SAKOL, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

WADE H. MCCREE, JR.,
Solicitor General,
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Petitioner challenges the constitutionality under the Fifth Amendment of Section 83 of the Internal Revenue Code of 1954 (26 U.S.C.). That statute provides that the value of property received as compensation for services shall be taxed as income in the year of receipt (or in the year it becomes nonforfeitable in the hands of the recipient employee) at its market value determined without regard to any restrictions on resale other than a restriction that will never lapse.

1. The undisputed facts are as follows: During 1972, petitioner was employed by Chesebrough-Pond's Inc. Chesebrough offered to its employees a stock purchase plan providing that one dollar par value common stock could be purchased for an amount equal to 14 times Chesebrough's average per share earnings during the preceding five years (Pet. App. A, p. 3a).

On May 7, 1971, petitioner purchased 140 shares at $21.20 per share. For one year thereafter, her shares were subject to forfeiture if she terminated her employment for any reason other than death. Moreover, petitioner was bound not to sell, pledge or transfer any interest in the shares for a five-year period ending May 7, 1976. The transfer restriction, however, could be waived by Chesebrough (Pet. App. A, p. 3a).

As of May 7, 1972, petitioner's 140 shares were no longer subject to forfeiture. Thus, pursuant to Section 83, the excess of the stock's fair market value ($66.50 per share) over its cost ($21.20 per share) was includable in petitioner's income for 1972. Petitioner included the $6,342 (140 x $45.30) in her gross income for that year and then deducted that amount in computing her adjusted gross income. On audit, the Commissioner determined a deficiency and petitioner sought a redetermination in the Tax Court (Pet. App. A, pp. 3a-4a).

The Tax Court held that Section 83 is a valid exercise of the taxing power and is constitutional (Pet. App. B, pp. 14a-30a). The court of appeals affirmed (Pet. App. A, pp. 1a-13a), stating that Section 83

does not "exhibit the kind of 'extreme and glaring' disregard of 'fair dealing,' * * * which amounts to confiscation, rather than taxation, in violation of the Fifth Amendment" (Pet. App. A, pp. 9a-10a). The court held that the statutory distinction between restrictions upon sale that will never lapse and those that will lapse complied with the Sixteenth Amendment (Pet. App. A, pp. 10a-13a).

2. The decision below correctly upheld the constitutionality of Section 83 of the Internal Revenue Code. As the court of appeals observed (Pet. App. A, p. 8a), the law prior to the enactment of Section 83 permitted tax avoidance through the use of restricted stock options. The employee did not take the value received into income until the lapse of any restrictions on sale but freely enjoyed the dividends and voting rights of stock ownership. In response, Section 83 requires that the employee include the value of the stock in income once there is no substantial risk of forfeiture, and that that value be determined without regard to transfer restrictions other than a restriction which by its terms will never lapse.

Petitioner contends (Pet. 9) that the statute's failure to take the value-depressing restrictions on sale into account violates the Due Process Clause of the Fifth Amendment because it imposes a tax on an amount that does not in fact exist. But as the court of appeals pointed out, the decisions of this Court establish that congressional judgments in the economic area will be upheld where there is a rational relation-

ship between the criteria set forth in the statutory mandate and a legitimate legislative purpose. See, *e.g.*, *Weinberger* v. *Salfi*, 422 U.S. 749; *Usery* v. *Turner Elkhorn Mining Co.*, 428 U.S. 1. See also *Goldberg* v. *Weinberger*, 546 F.2d 477, 480 (C.A. 2), certiorari denied, 431 U.S. 937.

Here, the determination that temporary restrictions on transfer should not be taken into account in fixing value was rationally related to Congress' concern with the tax-avoidance abuse connected with restricted stock options and therefore "justified the inherent imprecision of a prophylactic rule." *Weinberger* v. *Salfi*, *supra*, 422 U.S. at 777. Prior to the enactment of Section 83, most of the restrictions on transfer were imposed by the corporation in order to provide a tax benefit to the employee rather than to advance corporate objectives. Thus, Section 83 is a reasonable method of curbing such abuses by taking into account only permanent restrictions that are more likely to further a business purpose of the corporation. Moreover, since the corporation is always free to waive any restriction, Congress was amply justified in adopting a blanket rule excluding the effect of all temporary restrictions so as to avoid the difficulties of determining value on the basis of the subjective intent of the parties.

In support of her argument that the statutory presumption against restrictions violates the Fifth Amendment, petitioner relies (Pet. 6-10) upon *Heiner* v. *Donnan*, 285 U.S. 312; *Schlesinger* v. *Wisconsin*, 270 U.S. 230; and *Hoeper* v. *Tax Commission*, 284

U.S. 206. In *Donnan* and *Schlesinger*, the Court invalidated federal and state estate tax statutes that provided that gifts made within a certain period prior to a decedent's death were presumptively made in contemplation of death. In *Hoeper*, the Court struck down a state income tax statute that measured a husband's income with reference to his wife's income despite the fact that the wife's earnings were separate property under state law. Petitioner asserts that these decisions stand for the proposition that a tax statute cannot create a presumption that may be contrary to fact and urges that the presumption of Section 83 against restrictions upon transfer is therefore invalid.

But as the court of appeals pointed out (Pet. App. A, p. 7a n. 10), these early decisions can no longer be considered viable precedents in the light of *Usery* v. *Turner Elkhorn Mining Co.*, *supra* (upholding constitutionality of statutory presumption that miner affected with particular disease is disabled); *Weinberger* v. *Salfi*, *supra* (upholding constitutionality of federal statute precluding widows and their children from receiving social security benefits unless the claimant's relationship to the wage-earner existed at least nine months prior to his death); and *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 377 (upholding constitutionality of truth-in-lending rules requiring disclosure when installment purchase provides for four or more payments). See also Tribe, *American Constitutional Law* § 16-32, pp. 1095-1096 and n. 25 (1978).

Although petitioner recognizes the impact of these later decisions upon the irrebuttable presumption doctrine, she points out (Pet. 9-10) that the Court cited *Donnan*, *Schlesinger*, and *Hoeper* with approval in *Cleveland Board of Education* v. *LaFleur*, 414 U.S. 632, 644; *Vlandis* v. *Kline*, 412 U.S. 441, 446; *United States Department of Agriculture* v. *Murry*, 413 U.S. 508; and *Stanley* v. *Illinois*, 405 U.S. 645. But in *Turner Elkhorn Mining Co.*, *supra*, the Court stated that Congress is ordinarily accorded great leeway in "regulating purely economic matters" (428 U.S. at 23-24) and emphasized that conclusive presumptions in economic matters cannot be "equat[ed]" with presumptions "in the mold of *Stanley* and *Vlandis*" (*id.* at 22).

In response, petitioner argues (Pet. 11-13) that *Salfi* is limited to the question of eligibility for noncontractual government benefits and is inapplicable to a federal tax statute. But in taxing the benefits of stock received as compensation for services, Congress is regulating purely economic matters and is not purporting to affect the "rights to conceive and to raise one's children" as in *Stanley* (405 U.S. at 651), to judge the bona fides of a person's residence as in *Vlandis*, or to prescribe eligibility for public employment as in *LaFleur* (see page 7, note 1, *infra*). See *Weinberger* v. *Salfi*, *supra*, 422 U.S. at 770-772. Indeed, the Court has held that Congress has wide latitude in establishing classifications in federal tax statutes. *United States* v. *Maryland Savings-Share Insurance Corp.*, 400 U.S. 4.

There is no constitutional difference between the eligibility for social welfare benefits in *Salfi* and the collection of income taxes involved in this case. Both fall in the category of economic regulation and involve only a dispute between the government and an individual over a specific sum of money. As the Court stated in *Dandridge* v. *Williams*, 397 U.S. 471, 485, "[i]n the area of economics and social welfare, a State does not violate the Equal Protection Clause merely because the classifications made by its laws are imperfect. If the classification has some 'reasonable basis,' it does not offend the Constitution simply because the classification 'is not made with mathematical nicety or because in practice it results in some inequality.' *Lindsley* v. *National Carbonic Gas Co.*, 220 U.S. 61, 78. 'The problems of government are practical ones and may justify, if they do not require, rough accommodations—illogical, it may be, and unscientific.' *Metropolis Theatre Co.* v. *City of Chicago*, 228 U.S. 61, 69-70." [1]

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[1] *Gurmankin* v. *Costanzo*, 556 F.2d 184 (C.A. 3), which petitioner claims (Pet. 14-15) is in conflict with the decisions below, is not to the contrary. There, the court held invalid a school district policy prohibiting blind persons from teaching sighted students. Thus, the case does not involve social welfare benefits or economic regulations but eligibility for employment; it is therefore closely analogous to *Cleveland Board of Education* v. *LaFleur*, 414 U.S. 632 (invalidating local education board rules requiring pregnant teachers to take maternity leave without pay a specified number of months before and after the expected birth of her child).

The petition for a writ of certiorari should be denied.

Respectfully submitted.

WADE H. MCCREE, JR.,
Solicitor General.

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